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In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 193

PALM BEACH TRUST COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 12-25) is reported in 9 T. C. 1060. The opinion of the Court of Appeals (R. 39-40) is reported in 174 F. 2d 527.

JURISDICTION

The judgment of the Court of Appeals was entered on April 18, 1949. (R. 40-41.) The petition for a writ of certiorari was filed on July 15, 1949. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether the court below erred in affirming the decision of the Tax Court that the taxpayer was a "personal holding company" during the taxable year 1941 within the meaning of Section 501 (a) of the Internal Revenue Code and not a "bank" as defined in Section 104 (a) of the Code, exempt from classification as a personal holding company under Section 501 (b) of the Code.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the statutes and Regulations are printed in the Appendix, *infra*, pp. 15-20.

STATEMENT

The pertinent facts (including exhibits) were stipulated (R. 26-33) and were adopted by reference and found by the Tax Court accordingly (R. 12-16), as follows:[1]

The taxpayer filed its corporation income and declared value excess profits tax return for 1941 with the Collector of Internal Revenue for the District of Florida. It did not file a personal holding company return for the calendar year 1941. Its books of account have always been kept on the cash receipts and disbursements basis. (R. 12-13.)

The taxpayer was incorporated on May 25, 1929, as a trust company under the laws of the State of

[1] Other facts found by the Tax Court in respect of other issues (R. 16-19) decided in favor of the taxpayer by the Tax Court (R. 22-23), or by the court below (R. 39-40), have been omitted from the statement of facts here.

Florida, with all the rights, powers, and privileges granted and conferred by the trust laws of that State regulating the organization, powers, and management of trust companies, except those powers relating to title insurance and receiving money on deposit subject to check. (R. 13.)

The taxpayer's capital stock consisted of 1,000 shares of the par value of $100 per share, for which the subscribers paid $150 per share. The capital stock of the taxpayer was owned during 1941, as follows (R. 13):

Stockholder	*Shares owned*
John S. Phipps, president of petitioner	175
Henry C. Phipps, vice president of petitioner	200
Howard Phipps, vice president of petitioner	200
David T. Layman, Jr., secretary and treasurer of petitioner	15
R. C. Alley	10
Henry B. Martin trust	50
Townsend B. Martin trust	50
Esmond B. Martin trust	50
Alastair B. Martin trust	50
Amy Guest	200
Total	1,000

A certificate of authority to commence the business of a trust company was granted to the taxpayer by the Comptroller of the State of Florida under

date of September 22, 1930. (R. 13.) The certificate states (R. 14):

> *It being expressly understood that this certificate of authority does not extend to a general banking business, neither does it include the acceptance of trust business from individuals, partnerships and corporations other than those who may be stockholders of the company.*

This certificate of authority was replaced by an amended certificate of authority under date of March 2, 1937, which provided (R. 14) that—

> the Palm Beach Trust Company of Palm Beach in the County of Palm Beach and the State of Florida, is authorized to commence the business of a trust company (without title insurance powers) under the name above given with a capital stock of one hundred thousand dollars. It being expressly understood that this amended Certificate of Authority does not extend to a general banking business, as provided for in Paragraph 17, of Section 6126, Compiled General Laws of Florida.

During 1941, the taxpayer was subjected to supervision and examination by the authority of the State of Florida having supervision over banking institutions. In reply to an inquiry from the state auditor, the taxpayer on January 4, 1941, advised that as of December 31, 1940, it had deposited $50,000 face amount of Palm Beach County bonds and $50,000 cash with the state treasurer; and that the deposit represented 25% of its paid-in capital.

The office of the Comptroller of the State of Florida made examinations of the taxpayer as of the close of business June 30, 1941, and December 13, 1941. Formal reports thereon were filed. (R. 14.)

During the years 1937 to 1944, inclusive, the taxpayer declared itself trustee and acted as trustee of various mortgages on Florida real estate for the benefit of various holders of trust certificates. The declarations of trust were evidenced by written trust agreements and trust certificates executed by the taxpayer. (R. 14.)

The taxpayer maintained a journal and a ledger in which it recorded the transactions relating to the mortgages of which it had declared itself trustee. (R. 15.)

The taxpayer regularly prepared and transmitted to the mortgagors bills for interest and principal as the same became due with respect to the mortgages. The unpaid principal with respect to the mortgages as of January 1, 1941, amounted to approximately $300,000. (R. 15.)

During 1941, the taxpayer made approximately 50 collections aggregating approximately $90,000 on account of principal and interest with respect to the mortgages, and remitted these collections promptly to the beneficiaries named in the trust instruments, but rendered no bill and received no income for these services. Its officers received no salary in 1941 and the taxpayer did not receive any deposits from the general public. (R. 15.)

The beneficiaries of the trusts which the taxpayer administered during 1941 were for the most part children and grandchildren of two of the taxpayer's principal stockholders. Approximately 13% of the mortgages which the taxpayer held in trust was held for Henry C. Phipps, Amy Guest, and Molly Phipps (wife of Michael G. Phipps, who is the son of John S. Phipps), and the remaining mortgages which the taxpayer held in trust were held for the Bessemer Trust Company, which trust company was trustee for the following named individuals (R. 15-16):

John E. Phipps (grandson of John S. Phipps)
Margaret Douglas (daughter of John S. Phipps)
Michael G. Phipps (son of John S. Phipps)
Hubert B. Phipps (son of John S. Phipps)
Molly Phipps (wife of Michael G. Phipps, who is the son of John S. Phipps)
Sonia Phipps Farrell (daughter of Henry C. Phipps)
Dita Gordon Douglas (granddaughter of John S. Phipps)
Audrey Phipps Holden (daughter of Henry C. Phipps)
Barbara Phipps Janney (daughter of Henry C. Phipps)

John S. Phipps, Henry C. Phipps, and Howard Phipps were the principal organizers of the taxpayer. They were the owners of more than 50% of the stock. They were the controlling members of the board of directors and were the president

and vice presidents, respectively, of the taxpayer. The taxpayer in 1941 had made no disposition of its income since its organization and had paid no dividends. (R. 16.)

The income of the taxpayer in the year 1941 was derived from the following sources (R. 16):

Interest on loans, notes, mortgages, bonds, bank deposits, etc.....	$2,058.75
Gains on sales of securities, including gain on sale of Miami 2 per cent certificates (hereinafter mentioned)	12,534.70
Dividends	618.75
Total	15,212.20

The taxpayer was a "personal holding company" in 1941 and not a "bank." (R. 16.)

Upon the basis of these facts, the Tax Court, affirming the Commissioner's determination in respect of the issue involved here (R. 6-8), held that the taxpayer was not exempt as a "bank" from the personal holding company status[2] (R. 19-22), and the court below affirmed (R. 39-40).

ARGUMENT

1. The issue is whether the taxpayer was exempt in 1941 from classification and taxation as a personal holding company under Section 501 (b) of the Internal Revenue Code because it was a "bank"

[2] The Tax Court also held that the taxpayer was liable for the 25% penalty under Section 291 of the Internal Revenue Code (26 U.S.C. 1946 ed., Sec. 291) for failure to have filed a personal holding company tax return for 1941 (R. 23-24), but the court below reversed (R. 39-40), and the Government did not file a petition for a writ of certiorari.

as defined in Section 104 (a) (Appendix, *infra*, p. 15), it being conceded that the taxpayer otherwise meets the conditions for classification as a personal holding company set out in Sections 501, 502 and 503 (Appendix, *infra*, pp. 16-18). To qualify for the exemption, the taxpayer must have shown that a substantial part of its business consisted of exercising fiduciary powers similar to those permitted to national banks under Section 11 (k) of the Federal Reserve Act[3] (Appendix, *infra*, pp. 18-19).

We submit that both lower courts correctly held that the taxpayer's "business" did not include the fiduciary powers exercised by it in 1941. It was stipulated that the taxpayer received no income for the performance of fiduciary services in 1941 (R. 30) and the Tax Court's conclusion was warranted, if not compelled, that it performed them without the expectation of profit (R. 20-21).[4] The

[3] The taxpayer was incorporated and acted as a trust company with limited authority under the laws of Florida and was supervised and examined in 1941 by the state officer having supervision over banking institutions (R. 14), as required by Section 104 (a) for classification as a "bank". Whether the taxpayer was also "doing business" under the laws of Florida within the meaning of Section 104 (a) is not clear, but it was unnecessary to consider this point in the lower courts, since in any case the taxpayer's exercise of fiduciary powers was not a "business" activity.

[4] The taxpayer argues (Pet. 23-24) that it did not perform fiduciary services gratuitously. The stipulation of facts (R. 30) shows that at the time of the hearing on March 31, 1947 (R. 10), the taxpayer had rendered no bill for its services and had received nothing for the performance of such services. Clearly the inference is required that it performed the services in 1941 without charge.

activities thus do not qualify as "business." *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 171; *Chaloner* v. *Helvering*, 69 F. 2d 571, 572 (C. A. D. C.); cf. *Higgins* v. *Commissioner*, 312 U. S. 212, 217. It follows that the taxpayer's fiduciary activities were not a substantial part of its business; indeed they were no part of its business.[5] This consideration alone denies classification as a "bank" to the taxpayer.

Moreover, the taxpayer exercised its trust powers exclusively for the benefit of members of the Phipps family which controlled it, and not for the public, or a class thereof, generally, as a true bank or trust company would do. That Section 104 (a) contemplates something more than a family corporation performing fiduciary services for members of the family without charge is shown by its reference to Section 11 (k) of the Federal Reserve Act as a standard. That section deals with enumerated broad fiduciary powers which may be granted to national banks upon a showing of sufficient financial ability and other relevant factors so that "the needs of the community to be served" may be assured. Quite plainly the concept there is of a banking corporation which will exercise fiduciary powers for the public, or a class thereof, generally, rather than gratuitously for members of its controlling family only. Since the taxpayer per-

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[5] Petitioner's reliance (Pet. 19) on *Edwards* v. *Chile Copper Co.*, 270 U. S. 452, is misplaced, for the corporation there "was organized for profit and was doing what it principally was organized to do in order to realize profit." 270 U. S. at 455.

formed only limited fiduciary services without charge for members of its controlling family, it quite clearly was not a trust company within the meaning of Section 104 (a). Cf. *Jenkins* v. *Neff*, 163 N. Y. 320, 330; *People* v. *National Security Co.*, 177 N. Y. S. 838, 839; *Perpetual Executors and Trustees Association of Australia* v. *Swan*, L. R. A. C. (1898) 763, 764; 3 Bouvier's Law Dictionary (1914) 3333.

The purpose for which Sections 104 and 501 (b) were enacted confirms that this taxpayer, which is only a family corporation rendering services for the family, is not to be exempted from the personal holding company surtax as a "bank." The exemption granted by Sections 104 (b) and 501 (b) to banks and trust companies from all but the normal tax and surtax imposed by Sections 13, 14 and 15 of the Internal Revenue Code (26 U. S. C. 1946 ed., Secs. 13, 14 and 15) is obviously to insulate them from the heavy surtaxes imposed on corporations improperly accumulating surplus (Section 102 of the Internal Revenue Code (26 U. S. C. 1946 ed., Sec. 102)), and on the undistributed earnings of personal holding companies. Because banks and trust companies are often required to retain their earnings, rather than to distribute them, the exemption was afforded for the protection of their depositors. See H. Rep. No. 2475, 74th Cong., 2d Sess., p. 9 (1939-1 Cum. Bull. (Part 2) 667, 673); S. Rep. No. 2156, 74th Cong., 2d Sess., pp. 13-14

(1939-1 Cum. Bull. (Part 2) 678, 686); *Staunton Industrial L. Corp.* v. *Commissioner,* 120 F. 2d 930, 933 (C. A. 4th)—all dealing with Section 104 as originally enacted in the Revenue Act of 1936, c. 690, 49 Stat. 1648.[6] Cf. Section 351 (b)(1) of the Revenue Act of 1934, c. 277, 48 Stat. 680, which excluded from the term "personal holding company" "a bank or trust company incorporated under the laws of the United States or of any State or Territory, a substantial part of whose business is the receipt of deposits." With this purpose in mind, it is obvious that Congress would hardly have intended to include within the exemption a purely private family corporation, which acted as a fiduciary only for its controlling stockholders and members of their families, since no such considerations of public policy are involved. This seems particularly true, because other family corporations or associations performing the same fiduciary functions but not incorporated as a "trust company" under state law would be subject to the

[6] Sections 104 and 501 (b) originally appeared as Sections 104 and 351 (b), respectively, of the Revenue Act of 1936. That Act also enacted the controversial surtax on undistributed profits of corporations generally which was later abandoned. The principal object of Section 104 in that Act was to exempt banks from this tax. Under Section 104 (b) as it existed in 1941, a bank is liable for the ordinary surtax imposed on corporations by Section 15 of the Code (26 U.S.C. 1946 ed., Sec. 15), and the principal effect of Section 104 then is to exempt banks from the Section 102 surtax on improper accumulation of surplus. Section 501 (b) performs the same function as to personal holding company surtax. The original purpose of Congress in enacting Sections 104 and 501 (b) of course still remains.

personal holding company surtax. The mere fact, stressed by the taxpayer (Pet. 18), that it was classified as a trust company under state law, does not determine its status for purposes of Section 104 (a), which has its own additional criteria.

There is no merit to the taxpayer's argument (Pet. 21-22) that the lower courts construed the statute to mean that a trust company must actually engage in all the fiduciary activities specified by Section 11 (k) of the Federal Reserve Act, in order to be classed as a "bank". That was not the basis of the decision. The Tax Court's reasoning, concurred in by the Court of Appeals, was not that the taxpayer's fiduciary activities were not of sufficient variety, but that exemption should be denied because such activities were not carried on for profit and because they were performed only in a restricted and intimate family venture. (R. 21-22.) As already shown, the statutory provisions require that these factors be given effect.

2. The decision in this case is not in conflict with any other decision. Although the taxpayer asserts a conflict with five decisions of various circuits (Pet. 7-8, 10-13) and a probable conflict with *United States* v. *Cambridge Loan & Bldg. Co.*, 278 U. S. 55 (Pet. 8, 13-14), its discussion of these cases demonstrates that the factual situations and the questions presented were different from those in this case, thus removing any possibility of a direct conflict. Indeed, the taxpayer's asserted conflict

with three cases (*Pembroke Realty & S. Corp.* v. *Commissioner,* 122 F. 2d 252 (C. A. 2d); *Knight Newspapers* v. *Commissioner,* 143 F. 2d 1007 (C. A. 6th); and *Helvering* v. *Rebsamen Motors,* 128 F. 2d 584 (C. A. 8th)) rests only on its view that the lower court failed to give effect to the principles that the personal holding company surtax is highly penal, and that the statutory provisions imposing the surtax are to be strictly construed in the taxpayer's favor. (Pet. 11-12.) But the decision here does not disregard these principles.

A-C Inv. Ass'n v. *Helvering,* 68 F. 2d 386 (C. A. D. C.), decided by the same court which decided this case, is distinguishable from the decision here, since it involved a different statute, and different facts. Although in the *A-C Inv. Ass'n* case an association formed to handle and invest the savings of the numerous employees of a large cotton corporation was held to be exempt from all taxation as a mutual savings bank, despite the fact that it was a private, rather than a public, banking association, the controlling statute in that case (Section 231 (2) of the Revenue Acts of 1921 (c. 136, 42 Stat. 227), 1924 (c. 234, 43 Stat. 253) and 1926 (c. 27, 44 Stat. 9)), unlike the one here, exempted "Mutual savings banks not having a capital stock represented by shares" with no further limitations. Further, that case differs from the present case in that there the association operated for profit, its average earnings being about 7% (p. 387), and it was consistent

with the purpose underlying the exemption statute, namely, to stimulate savings and thrift (p. 390), to treat the association as a mutual savings bank.

3. Since the judgment in this case is correct and is not in conflict with any other decision, the case does not require further review by this Court. For the reason that the decision turns on the particular facts of this case, we believe that the taxpayer's statement as to its possible importance in relation to private investment companies generally (Pet. 10) is considerably magnified.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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AUGUST, 1949.

APPENDIX

Internal Revenue Code:

SEC. 104. BANKS AND TRUST COMPANIES.

(a) *Definition.*—As used in this section the term "bank" means a bank or trust company incorporated and doing business under the laws of the United States (including laws relating to the District of Columbia), of any State, or of any Territory, a substantial part of the business of which consists of receiving deposits and making loans and discounts, or of exercising fiduciary powers similar to those permitted to national banks under section 11 (k) of the Federal Reserve Act, 38 Stat. 262 (U. S. C., Title 12, Sec. 248k), as amended, and which is subject by law to supervision and examination by State, Territorial or Federal authority having supervision over banking institutions.

(b) [As amended by Sec. 104 (c) of the Revenue Act of 1941, c. 412, 55 Stat. 687] *Rate of Tax.*—Banks shall be subject to tax under section 13 or section 14 (b), and under section 15.

(26 U. S. C. 1946 ed., Sec. 104.)

SEC. 500 [As amended by Sec. 110 (a) of the Revenue Act of 1941, *supra*]. SURTAX ON PERSONAL HOLDING COMPANIES.

There shall be levied, collected, and paid, for each taxable year beginning after December 31, 1938, upon the undistributed subchapter A net income of every personal holding com-

pany (in addition to the taxes imposed by chapter 1), a surtax equal to the sum of the following:

(1) 71½ per centum of the amount thereof not in excess of $2,000; plus

(2) 82½ per centum of the amount thereof in excess of $2,000.

(26 U. S. C. 1946 ed., Sec. 500.)

SEC. 501. DEFINITION OF PERSONAL HOLDING COMPANY.

(a) *General Rule.*—For the purposes of this subchapter and chapter 1, the term "personal holding company" means any corporation if—

(1) *Gross income requirement.*—At least 80 per centum of its gross income for the taxable year is personal holding company income as defined in section 502; but if the corporation is a personal holding company with respect to any taxable year beginning after December 31, 1936, then, for each subsequent taxable year, the minimum percentage shall be 70 per centum in lieu of 80 per centum, until a taxable year during the whole of the last half of which the stock ownership required by paragraph (2) does not exist, or until the expiration of three consecutive taxable years in each of which less than 70 per centum of the gross income is personal holding company income; and

(2) *Stock ownership requirement.*—At any time during the last half of the taxable

year more than 50 per centum in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals.

(b) *Exceptions.*—The term "personal holding company" does not include a corporation exempt from taxation under section 101, a bank as defined in section 104 * * *.

* * * *

(26 U. S. C. 1946 ed., Sec. 501.)

SEC. 502. PERSONAL HOLDING COMPANY INCOME.

For the purposes of this subchapter the term "personal holding company income" means the portion of the gross income which consists of:

(a) Dividends, interest (other than interest constituting rent as defined in subsection (g)), royalties (other than mineral, oil, or gas royalties), annuities.

(b) *Stock and Securities Transactions.*—Except in the case of regular dealers in stock or securities, gains from the sale or exchange of stock or securities.

* * * *

(26 U. S. C. 1946 ed., Sec. 502.)

SEC. 503. STOCK OWNERSHIP.

(a) *Constructive Ownership.*—For the purpose of determining whether a corporation is a personal holding company, insofar as such

determination is based on stock ownership under section 501 (a) (2), section 502 (e), or section 502 (f)—

(1) *Stock not owned by individual*—Stock owned, directly or indirectly, by or for a corporation, partnership, estate, or trust shall be considered as being owned proportionately by its shareholders, partners, or beneficiaries.

(2) *Family and partnership ownership.*—An individual shall be considered as owning the stock owned, directly or indirectly, by or for his family or by or for his partner. For the purposes of this paragraph the family of an individual includes only his brothers and sisters (whether by the whole or half blood), spouse, ancestors, and lineal descendants.

* * * *

(26 U. S. C. 1946 ed., Sec. 503.)

Federal Reserve Act of December 23, 1913, c. 6, 38 Stat. 251:

SEC. 11. The Federal Reserve Board shall be authorized and empowered:

* * * *

(k) [As amended and reenacted by Sec. 2 of the Act of September 26, 1918, c. 177, 40 Stat. 967, 968, 969.] To grant by special permit to national banks applying therefor, when not in contravention of State or local law, the right to act as trustee, executor, administrator, registrar of stocks and bonds, guardian of estates,

assignee, receiver, committee of estates of lunatics, or in any other fiduciary capacity in which State banks, trust companies, or other corporations which come into competition with national banks are permitted to act under the laws of the State in which the national bank is located.

* * * *

In passing upon applications for permission to exercise the powers enumerated in this subsection, the Federal Reserve Board may take into consideration the amount of capital and surplus of the applying bank, whether or not such capital and surplus is sufficient under the circumstances of the case, the needs of the community to be served, and any other facts and circumstances that seem to it proper, and may grant or refuse the application accordingly: * * *.

* * * *

(12 U. S. C. 1946 ed., Sec. 248.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.502-1. *Personal holding company income.*—The term "personal holding company income" means the portion of the gross income which consists of the following:

* * * *

(5) *Gains from the sale or exchange of stock or securities.*—The term "gains from the sale or exchange of stock or securities" as used

in section 502 (b) applies to all gains * * * from the sale or exchange of stock or securities includible in gross income. The term "stock or securities" as used in section 502 (b) includes shares or certificates of stock, or * * * bonds, debentures, certificates of indebtedness, notes, car trust certificates, bills of exchange, obligations issued by or on behalf of a Government, State, Territory, or political subdivision thereof. * * *

* * * *

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